COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, NOVEMBER 5, 1998

JOINT APPLICATION OF

CASE NO. PUA960057

DELMARVA POWER & LIGHT COMPANY
and
DELMARVA CAPITAL INVESTMENTS, INC.

For approval of transactions under
Chapter 4 of Title 56 of the
Code of Virginia

ORDER DENYING APPROVAL

Delmarva Power & Light Company ("Delmarva") and Delmarva Capital Investments, Inc., ("DCI") (collectively referenced as "Applicants") filed a joint application with the Commission seeking retroactive approval pursuant to the Public Utilities Affiliates Act or an exemption from the filing and prior approval requirements of Chapter 4 of Title 56 of the Code of Virginia. In their joint application, Applicants request approval of the following: 1) the provision of services by Delmarva to its subidiaries, both under a management fee agreement and otherwise; 2) transactions regarding the Delaware City Power Plant; 3) transactions regarding the sale and contribution of real property to affiliates; and 4) the initial and subsequent capital contributions by Delmarva to its direct subsidiaries.

Since the filing of the joint application, the Commission, in Case No. PUA970008 (Order entered August 6, 1997), approved the corporate reorganization (merger) of Delmarva and Atlantic City Electric Company. Pursuant to that merger Delmarva and its direct/indirect subsidiaries became wholly-owned subsidiaries of Conectiv, Inc. The Commission also approved, in Case No. PUA970040 (Order entered June 18, 1998), the establishment of a mutual service company and certain affiliate transactions and the granting of a dividend to Conectiv, Inc. of Delmarva's direct/indirect subsidiaries.

DCI was a wholly-owned, direct, non-regulated subsidiary of Delmarva incorporated in Delaware. DCI had a number of direct or indirect wholly-owned subsidiaries that were Delaware or Pennsylvania corporations. In addition to DCI, Delmarva had three other direct, non-regulated subsidiaries: Delmarva Services Company, Delmarva Industries, Inc., and Delmarva Energy, Inc.

All of Delmarva's indirect subsidiaries (eighteen) were Delaware or Pennsylvania corporations and were wholly-owned, directly or indirectly, by DCI. None of Delmarva's direct or indirect subsidiaries was engaged in any business anywhere within the Commonwealth of Virginia.

Delmarva's corporate policy regarding transactions between itself and its subsidiaries kept its regulated utility service

activities separate from the activities of its direct and indirect subsidiaries. Delmarva also tracked and directly assigned costs to its subsidiaries on a fully allocated basis, thereby preventing any cross subsidization of subsidiary activities.

Delmarva is requesting retroactive approval or an exemption from such approval for services it provided to DCI under a management fee agreement. The management fee was in addition to the other direct/indirect costs associated with services provided to DCI. The management fee was based on a review of all other costs incurred by Delmarva for its subsidiaries and was formulated to charge for certain miscellaneous and supervisory costs not practicably identifiable for direct charging. The following categories of costs were included in developing the annual management fee: 1) executive management; 2) human resources; 3) accounting and finance; 4) general services; 5) corporate communications; and 6) information systems. In addition to the aforementioned costs categories, costs for annual stockholder meetings, directors' and officers' liability insurance, general liability insurance, general postage and parking were reflected in the management fee. The management fee was $5,000 per month from 1986 to 1994; $10,000 per month in 1995 and 1996; and was expected to increase to $12,500 in 1997. Delmarva stated that approximately 3% of the

monthly management fee (revenue) was assigned to Virginia jurisdictional cost of service studies.

Delmarva also is requesting retroactive approval or an exemption for miscellaneous limited support services provided to its subsidiaries. Such services included: 1) engineering; 2) accounting and finance; 3) legal; and 4) other services (i.e., marketing, fuel management, environmental public relations, and real estate). Delmarva stated that the aforementioned services were provided, without a written agreement, to its subsidiaries to enable them to operate in an efficient manner and to ensure integration and coordination of activities, information gathering and consolidated financial reporting. Delmarva also stated that all expenses related to support service transactions were recorded as a receivable from associated companies on its financial books and a corresponding payable to associated companies was recorded on the subsidiaries' financial books. As such, no revenue was recorded on Delmarva's books and the transactions, therefore, had no impact on Virginia jurisdictional cost of service studies.

Delmarva also requests retroactive approval or an exemption for services provided to the Delaware City Power Plant. Until 1992, Delmarva owned the Delaware City Power Plant (located in Delaware) and operated the plant under a contract with Star Enterprise and its corporate predecessors. The facility was

used primarily to serve the electric and steam needs of the Star Enterprise refinery. In 1991, Star Enterprise exercised a contractual option to purchase the Delaware City Power Plant effective January 1, 1992, at book value. After the purchase, the approximately 100 Delmarva employees at the plant continued to operate the facility as they had for more than 30 years. With the change in ownership, the work was performed under an operations and maintenance agreement between Delmarva and Star Enterprise. At the end of 1992, the contract to operate the Star Enterprise facility was assigned to Delstar Operating Company, a subsidiary of DCI. Delmarva stated that all expenses related to the basic services portion of the O&M Agreement, any additional services, and any construction services were recorded as a receivable from associated companies on its financial books and a corresponding payable to associated companies was recorded on the subsidiaries' financial books. As such, there was no impact on Virginia jurisdictional customers as no revenue or expense was recorded on Delmarva's books. Any profit or loss was recorded below the line on Delmarva's financial books and also had no impact on Virginia jurisdictional customers.

In addition, Delmarva is requesting retroactive approval or an exemption for transactions involving the sale and contribution of excess undeveloped real property to DCI, Delmarva Services Company and Delmarva Capital Realty Company;

i.e., property not necessary to the operation of its utility business. Delmarva stated that it did not have the right of eminent domain in Delaware and, therefore, was occasionally obligated to purchase larger parcels of land than were necessary for utility purposes. The book value of the real property transferred amounted to approximately $2.9 million of which approximately $2.6 million of such property may have been included in Virginia jurisdictional cost of service studies at various points in the past. In addition, approximately $6.8 million (after taxes) was realized from sales of some of such properties.

And finally, Delmarva requests retroactive approval of capital contributions, in excess of $91 million, made to its direct subsidiaries.

Delmarva stated that it did not request Commission approval for any of the transactions because: 1) the services had no affect on electric services rendered to Virginia jurisdictional customers; 2) any revenue assigned to Virginia customers was a *de minimis* amount (management fee agreement); 3) no revenue or expense related to the miscellaneous support services was included in a Virginia cost of service study; 4) the power plant was not located in Virginia and virtually all of the power generated was used to serve Star Enterprise (an adjacent industrial customer); and 5) the real property transactions

involved property located outside the Commonwealth of Virginia and had no impact on Virginia customers.

On October 7, 1998, Staff filed a report detailing the results of its review and recommending denial of the requested approvals. Staff stated that it believed that the above transactions came within the purview of Chapter 4 of Title 56 of the Code of Virginia and that prior approval should have requested. Staff also noted that retroactive approval was unwarranted for the management fee arrangement due to the subsequent reorganization of Delmarva and the implementation of a new accounting system that eliminates the need for a monthly management fee. Staff did not believe that the Commission should approve any of the transactions because the Applicants have not provided the needed assurance that no cross subsidization has occurred among Delmarva and its affiliates in providing services. Neither have the Applicants provided the needed assurance that ratepayers have not been harmed by the real estate or capital contributions transactions. Finally, it was Staff's position that, since the applicant corporations have been extensively reorganized, no public purpose would be served by granting such approval.

In its report Staff noted that it had discussed its concerns with Delmarva and that Delmarva represents that, in light of those concerns and the Commission's policy established

in Case No. PUE830029, it would offer to make a one time refund of $76,000 to Virginia ratepayers. In a letter dated October 8,1998, counsel for Delmarva confirmed that it would make such refunds on its customers' bills within 60 days after entry of a Commission order directing such refunds.

NOW THE COMMISSION, upon consideration of the joint application and representations of the Applicants and having been advised by its Staff, is of the opinion and finds that Applicants' request for approval of the above referenced transactions should not be granted. We will deny Applicants' request for approval but will require no further action on the part of Applicants except the agreed upon refund. While we require no further action in this proceeding, we will, in the future, expect Applicants to file for prior approval of all of their affiliate transactions consistent with the statutory requirements of § 56-77. Accordingly,

IT IS ORDERED THAT:

(1) The joint application is hereby denied.

(2) On or before 60 days from the date of this Order, Delmarva shall complete the above referenced $76,000 refund to its Virginia ratepayers.

(3) The refund ordered in Paragraph (2) may be accomplished by credit to the appropriate customer's account for current customers.

(4) On or before February 1, 1999, Delmarva shall file with the Commission's Division of Public Utility Accounting a document showing that all refunds have been lawfully made pursuant to this Order and itemizing the cost of the refund and accounts charged. Such itemization of costs shall include, inter alia, computer costs, and the personnel-hours, associated salaries and cost for verifying and correcting the refund methodology and developing the computer program.

(5) Delmarva shall bear all costs of the refunding directed in this Order.

(6) There being nothing further to come before the Commission, this matter shall be removed from the docket and the papers placed in the file for ended causes.